the Act.[1594] Ancillary jurisdiction may be employed, at the Commission's discretion, when two conditions are satisfied: "(1) the Commission's general jurisdictional grant under Title I of the Act covers the regulated subject and (2) the regulations are reasonably ancillary to the Commission's effective performance of its statutorily mandated responsibilities."[1595] Both incumbent LECs and CMRS providers are telecommunications carriers, over which we have clear jurisdiction. Further, to meaningfully implement intercarrier compensation requirements established pursuant to sections 201, 332, and 251(b)(5) against the backdrop of mandatory interconnection and prohibitions on blocking traffic under sections 201 and 251(a)(1), it was appropriate for the *T-Mobile Order* to impose requirements on CMRS providers beyond those expressly covered by the language of section 252.

838. As discussed above, pursuant to the authority of sections 201 and 332, the Commission required interconnected LECs and CMRS providers to pay mutual compensation for the non-access traffic that they exchange.[1596] Even if sections 201 and 332 were not viewed as providing direct authority to require that CMRS providers negotiate interconnection agreements with incumbents LECs for the exchange of non-access traffic under the section 252 framework, such action clearly is reasonably ancillary to the Commission's authority under those provisions, including the associated requirement to pay mutual compensation. Likewise, although section 251(b)(5) does not itself require CMRS providers to enter reciprocal compensation arrangements, the Commission brought intraMTA LEC-CMRS traffic within that framework.[1597] CMRS providers received certain benefits from this regime,[1598] and the Commission likewise anticipated that they would enter agreements under which they would both "receive reciprocal compensation for terminating certain traffic that originates on the networks of other carriers, and . . . pay such compensation for certain traffic that they transmit and terminate to other carriers."[1599] Further, when carriers are indirectly interconnected pursuant to section 251(a)(1), as is often the case for LECs and CMRS providers, the carriers' interconnection arrangements can be relevant to addressing the appropriate reciprocal compensation, as the Commission recently recognized.[1600]

839. Given that the Commission prohibited tariffing of wireless termination charges for non-access traffic on a prospective basis, LECs needed to enter into agreements with CMRS providers providing for compensation under those regimes. Because LEC-CMRS interconnection is compelled by section 251(a)(1) of the Act, and section 201 of the Act also generally restricts carriers from blocking

[1594] *See, e.g.*, SBC Opposition, CC Docket No. 01-92 (filed June 30, 2005) (citing the Commission's "authority under 47 U.S.C. § 154(i) to 'make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions'").

[1595] *Comcast Corp. v. FCC*, 600 F.3d 642, 646 (D.C. Cir. 2010) quoting *Am. Library Ass'n v. FCC*, 406 F.3d 689, 691-692 (D.C. Cir. 2005).

[1596] *See supra* para. 834.

[1597] *See infra* Section XV.

[1598] *See, e.g., Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1042 ("We therefore conclude that section 251(b)(5) prohibits charges such as those some incumbent LECs currently impose on CMRS providers for LEC-originated traffic. As of the effective date of this Order, a LEC must cease charging a CMRS provider or other carrier for terminating LEC-originated traffic and must provide that traffic to the CMRS provider or other carrier without charge.").

[1599] *See, e.g., Local Competition First Report and Order*, 11 FCC Rcd at 16018, para. 1045.

[1600] *Petition of CRC Communications of Maine, Inc. and Time Warner Cable Inc. for Preemption Pursuant to Section 253 of the Communications Act, as Amended, et al.*, WC Docket No. 10-143, CC Docket No. 01-92, GN Docket No. 09-51, Declaratory Ruling, 26 FCC Rcd 8259, 8270, para. 21 (2011) (*Interconnection Clarification Order*).

traffic,[1601] experience revealed that incumbent LECs would have limited practical ability to ensure that CMRS providers negotiated and entered such agreements because they could not avoid terminating the traffic even in the absence of an agreement to pay compensation. To ensure that the balance of regulatory benefits intended for each party under the LEC-CMRS interconnection and compensation regimes was not frustrated, it was necessary for the Commission to establish a mechanism by which incumbent LECs could request interconnection, and associated compensation, from CMRS providers, and ensure that those providers would negotiate those agreements, subject to an appropriate regulatory backstop. Thus, the Commission's section 4(i) authority also supports the *T-Mobile Order* requirement that CMRS providers negotiate interconnection agreements with incumbent LECs in good faith under the section 252 framework.

(ii) Consistency with the Communications Act and the Administrative Procedures Act

840. In response to the concerns of some Petitioners, we clarify that the negotiation and arbitration requirements adopted for CMRS providers in the *T-Mobile Order* did not impose section 251(c) on CMRS providers.[1602] As commenters observe, with one exception, the requirements of section 251(c) expressly apply to incumbent LECs, and nothing in the *T-Mobile Order* attempts to extend those statutory requirements to CMRS providers.[1603] Nor does the reference to "interconnection" in section 20.11(e) of the Commission's rules apply to CMRS providers the statutory interconnection obligations governing incumbent LECs under section 251(c)(2).[1604] As the *T-Mobile Order* makes clear, the primary focus of that rule is to provide a mechanism to implement mutual compensation for non-access traffic between incumbent LECs and CMRS providers.[1605] However, the Commission's mutual compensation rules were adopted in the context of addressing LEC-CMRS interconnection, against a backdrop where "interconnection" regulations were understood to encompass not only the physical connection of networks, but also the associated intercarrier compensation.[1606] In addition, as the Commission recently

[1601] Although the Commission's prohibitions on blocking under section 201 generally apply to interstate traffic, *see, e.g.*, *Call Blocking Declaratory Ruling*, 22 FCC Rcd 11629, given LECs' indirect interconnection with CMRS providers, and the fact that CMRS providers' telephone numbers are not tied to particular geographic locations, it is unclear that a LEC that undertook to block intrastate CMRS traffic could avoid blocking interstate traffic.

[1602] *See generally* AAPC Petition at 4; RCA Petition at 2, 5-6, 8-11. *But see, e.g.*, MetroPCS Communications Petition for Limited Clarification or Partial Reconsideration, CC Docket No. 01-92 at 2 n.8 (filed Apr. 29, 2005) (MetroPCS Petition) ("The *Order* was not intended to impose upon other CMRS carriers the panoply of duties under Section 251(c) of the Act - - e.g., the duty to provide direct interconnection under § 251(c)(2), the duty to provide unbundled access under § 251(c)(3), the duty to offer resale under § 251(c)(4), the duty to provide notice of changes under § 251(c)(4) or the duty to allow collocation under § 251(c)(5)."); T-Mobile Opposition and Comments, CC Docket No. 01-92 at 5 (filed June 30, 2005) ("T-Mobile does not read the *WTT Order* as having imposed interconnection obligations on CMRS providers pursuant to the Commission's authority to implement Section 251(c) of the Communications Act.").

[1603] *See, e.g.*, AllTel Opposition, CC Docket No. 01-92, at 2-3 (filed June 30, 2005); Leap Comments, CC Docket No. 01-92 at 4 (filed June 30, 2005). Section 251(c)(1) also requires "requesting telecommunications carriers . . . to negotiate in good faith the terms and conditions of" interconnection agreements. 47 U.S.C. § 251(c)(1).

[1604] *See, e.g.*, RCA Petition at 3, 5-6, 9.

[1605] *See, e.g.*, *T-Mobile Order*, 20 FCC Rcd at 4864-65, 15-16.

[1606] *See supra* para 835. We thus conclude that the definition of "interconnection" in section 51.5 of the Commission's rules is not dispositive of the interpretation of that term here. *See, e.g.*, RCA Petition at 4 (citing the definition of "interconnection" in 47 C.F.R. § 51.5, which is focused on "the linking of two networks" and excluding "transport and termination of traffic"). This rule was codified in Part 20, not Part 51.

recognized, interconnection arrangements can bear on the resolution of disputes regarding reciprocal compensation under the section 252 framework.[1607] For example, while interconnection for the exchange of access traffic does not currently implicate section 251(b), an interconnection agreement for the exchange of reciprocal compensation traffic may contain terms relevant to determining appropriate rates under the statute and Commission rules.[1608] Moreover, section 20.11(e) of the Commission's rules does not supplant or expand the otherwise-applicable interconnection obligations for CMRS providers, as some contend.[1609] Thus, in response to a request by an incumbent LEC for interconnection under section 20.11(e), CMRS providers are not required to enter into direct interconnection, and may instead satisfy their obligation to interconnect through indirect arrangements.

841. Similarly, the Commission did not interpret section 252 as binding on CMRS providers in the same manner as incumbent LECs.[1610] Rather, the Commission exercised its authority under sections 201, 332, 251 and 4(i) to apply to CMRS providers' duties analogous to the negotiation and arbitration requirements expressly imposed on incumbent LECs under section 252.[1611] Although Congress did not expressly extend these requirements this broadly in section 252 of the Act, our

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[1607] *Petition of CRC Communications of Maine, Inc. and Time Warner Cable Inc. for Preemption Pursuant to Section 253 of the Communications Act, as Amended, et al.*, WC Docket No. 10-143, CC Docket No. 01-92, GN Docket No. 09-51, Declaratory Ruling, 26 FCC Rcd 8259, 8270, para. 21 (2011) (*Interconnection Clarification Order*); *Local Competition First Report and Order*, 11 FCC Rcd at 15991, para. 997 ("we find that indirect connection (e.g., two non-incumbent LECs interconnecting with an incumbent LEC's network) satisfies a telecommunications carrier's duty to interconnect pursuant to 251(a)").

[1608] *See, e.g.*, 47 U.S.C. §§ 251(b)(5), 252(d)(2)(A); 47 C.F.R. § 51.701(b)(1) (specifically excluding "interstate or intrastate exchange access, information access, or exchange services for such access" from the scope of the reciprocal compensation pricing rules); *Local Competition First Report and Order*, 11 FCC Rcd at 16012-25, paras. 1033-59; *see also id.*

[1609] *See, e.g.*, RCA Petition at 3, 5-6, 9. *See also, e.g.*, Nextel Partners Comments and Opposition, CC Docket No. 01-92 at (filed June 30, 2005) (arguing that section 20.11(e) of the Commission's rules should not be interpreted to "impose new physical interconnection negotiations on CMRS providers"); Qwest Opposition, CC Docket No. 01-92 at 2 n.4 (filed June 30, 2005) (acknowledging that "ILECs do not have a statutory right to demand Section 251(b) or (c) interconnection with CMRS carriers," but that "they certainly have the right to demand interconnection with CMRS providers pursuant to Sections 201(a) and 251(a) of the Act and to insist that the CMRS provider conduct itself in good faith during the negotiation (and performance) phases of the agreement."); Cingular Wireless Reply, CC Docket No. 01-92 at 2-4 (filed July 11, 2005) (arguing that the *T-Mobile Order* should not be interpreted to impose a new direct interconnection requirement on CMRS providers). For these same reasons, we reject the claim that section 20.11(e) is in conflict with section 20.11(a) of the Commission's rules, which grants CMRS providers certain interconnection rights with respect to incumbent LECs. *See* RCA Petition at 5-6 (citing 47 C.F.R. § 20.11(a)). Nothing in section 20.11(e) of the Commission's rules should be read to eliminate CMRS providers' rights under section 20.11(a).

[1610] *See, e.g.*, *T-Mobile Order*, 20 FCC Rcd at 4864, para. 15 (observing that "LECs may not require CMRS providers to negotiate interconnection agreements or submit to arbitration under section 252 of the Act"). As AAPC observes, for example, "the *ILEC's* receipt of a request for interconnection from another telecommunications carrier is an explicit condition precedent" to a petition for arbitration under section 252. AAPC Petition at 4 (citing 47 U.S.C. § 252(b)(1)) (emphasis in original).

[1611] *See, e.g.*, CTIA Opposition, CC Docket No. 01-92 at 6 (filed June 30, 2005) ("Thus, the references to Section 252 in the *Order* and in the amended Section 20.11 were simply a shorthand way of generally describing the procedures that the Commission intended to make available to the requesting ILECs in negotiating reciprocal compensation agreements."); T-Mobile Opposition and Comments, CC Docket No. 01-92 at 6 (filed June 30, 2005) ("The Commission also should clarify that, as discussed above, any reference to negotiation and arbitration procedures under Section 252 is solely a shorthand for procedures similar to those that the Commission has applied under Section 252, rather than reliance upon Section 252 as its jurisdictional authority.").

subsequent experience with interconnection and intercarrier compensation, as described above, demonstrate the need for the duties imposed on CMRS providers in the *T-Mobile Order*.[1612] Thus, the Commission sensibly required CMRS providers to negotiate interconnection agreements with incumbent LECs in good faith, subject to arbitration by the state or, where the state lacks authority[1613] or otherwise fails to act,[1614] by the Commission.[1615] This approach also is supported by the concept of cooperative federalism, which is reasonably contemplated by sections 251 and 252 of the Act.[1616] Because of the cooperative federalism embodied by sections 251 and 252, and the role of the Commission in arbitrating interconnection disputes under the section 252 framework when states lack authority or otherwise fail to act, we also reject claims that the *T-Mobile Order* constituted an unlawful delegation to the states.[1617]

842. We also do not interpret silence in certain provisions of the Act regarding the duties of CMRS providers as precluding the Commission's action in the *T-Mobile Order*. For one, we reject requests that we ignore the Commission's experience with interconnection and intercarrier compensation and treat Congress' silence regarding the rights of incumbent LECs to invoke negotiation and arbitration in section 252 of the Act as equivalent to a statutory prohibition on extending such rights.[1618] Nor are we persuaded that the language of section 332(c)(1)(B) precludes the Commission's extension of section

[1612] *See supra* paras. 828-836.

[1613] *See, e.g., Petition of WorldCom, Inc. for Preemption of Jurisdiction of the Virginia State Corporation Commission Pursuant to Section 252(e)(5) of the Telecommunications Act of 1996 and for Arbitration of Interconnection Disputes With Verizon-Virginia, Inc.*, CC Docket No. 00-218, Memorandum Opinion and Order, 16 FCC Rcd 6224 (2001).

[1614] *See, e.g., Petition of Northland Networks, Ltd. For Preemption of the Jurisdiction of the New York Public Service Commission Pursuant to Section 252(e)(5) of the Communications Act of 1934, as Amended*, WC Docket No. 03-242, Memorandum Opinion and Order, 19 FCC Rcd 2396 (Wir. Comp. Bur. 2004).

[1615] *See generally* 47 C.F.R. Part 51, Subpart I.

[1616] *See, e.g., Core v. Verizon PA*, 493 F.3d 333 (3d Cir. 2007); *Centennial Puerto Rico License Corp. v. Telecom. Reg. Bd. of Puerto Rico*, 634 F.3d 17, 22 (1st Cir. 2011).

[1617] *See, e.g.*, AAPC Petition at 6; RCA Reply, CC Docket No. 01-92 at 7-9 (filed July 11, 2005). We also disagree with RCA that a role for the states is at odds with the "uniform, national deregulatory environment for CMRS" that "Congress sought to achieve." RCA Reply, CC Docket No. 01-92 at 7-8 (filed July 11, 2005). As the D.C. Circuit recently recognized, a state role in the context of LEC-CMRS interconnection issues can be "consistent with the dual regulatory scheme assumed in the Communications Act" notwithstanding concerns about a resulting "patchwork of regulatory schemes throughout the states [that could] undermine Congress's understanding that 'mobile services ... by their nature, operate without regard to state lines as an integral part of the national telecommunications infrastructure.'" *MetroPCS v. FCC*, 644 F.3d 410, 413-14 (D.C. Cir. 2011). *See also id.* at 414 ("the FCC's reasonable reading of the Communications Act and Rule 20.11(b) is not disturbed by MetroPCS's wish that the FCC do it all, which finds no expression in the statute").

[1618] *Compare, e.g.*, RCA Reply, CC Docket No. 01-92 at 6 (filed July 11, 2005) (arguing that, because section 252 expressly imposes certain obligations on incumbent LECs, it is inconsistent with the Act to impose those requirements on other carriers) *with, e.g.*, SBC Opposition, CC Docket No. 01-92 at 5 (filed June 30, 2005) (arguing that the focus on incumbent LECs in section 252 "by no means prohibits the Commission from adopting a rule allowing ILECs to request negotiations"). RCA further observes that section 251(c)(1) expressly requires incumbent LECs to negotiate interconnection agreements in good faith "in accordance with section 252," while the good faith negotiation requirement for requesting carriers does not specifically reference section 252. RCA Reply, CC Docket No. 01-92 at 6 (filed July 11, 2005). This simply reflects the explicit focus on incumbent LECs in the text of section 252, however. Because we do not interpret the Act's silence in section 252 regarding implementation procedures governing non-incumbent LECs as precluding section 20.11(e) of the Commission's rules, we likewise do not interpret section 251(c)(1) in that manner.

252-type procedures in this manner. RCA observes that section 332(c)(1)(B) only expressly discusses requests *by* CMRS providers for interconnection, and contends that precludes rules that would enable incumbent LECs to request interconnection *from* CMRS providers.[1619] As a threshold matter, we observe that CMRS providers are required to interconnect with other carriers under section 251(a) of the Act, and that section 201 also provides the Commission authority to require CMRS providers to interconnect. We thus disagree with RCA's suggestion that section 332 should be read to preclude CMRS providers from being subject to such requests.[1620] With respect to the procedures for implementing such requests, however, we note that the Commission previously has suggested "that the procedures of section 252 are not applicable in matters involving section 251(a) alone."[1621] We find it appropriate to interpret the obligations imposed on CMRS providers under section 20.11(e) in a manner consistent with the Commission's interpretation of the scope of the comparable requirements of section 252 from which it was derived. We thus make clear that section 20.11(e) does not apply to requests for direct or indirect physical interconnection alone, but only requests that also implicate the rates and terms for exchange of non-access traffic.

843. We further find that the rules adopted in the *T-Mobile Order* were procedurally proper, contrary to the contentions of some petitioners.[1622] The Commission's 2001 *Intercarrier Compensation NPRM* expressly sought "comment on the rules [the Commission] should adopt to govern LEC interconnection arrangements with CMRS providers, whether pursuant to section 332, or other statutory authority,"[1623] and "on the relationship between the CMRS interconnection authority assigned to the Commission under sections 201 and 332, and that granted to the states under sections 251 and 252."[1624] The T-Mobile petition was incorporated into the docket in that proceeding, and in response to the Commission's request for comment on that petition,[1625] the issue of LECs being able to request interconnection negotiations with CMRS carriers was raised in the record.[1626] We thus are not persuaded

[1619] RCA Reply, CC Docket No. 01-92 at 5 (filed July 11, 2005).

[1620] *See, e.g., Policy and Rules Concerning the Interstate Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as Amended; Petitions for Forbearance*, CC Docket No. 96-61, Memorandum Opinion and Order, 14 FCC Rcd 391, 398, para. 15 (1998) ("the interconnection requirements of section 251(a) clearly apply to CMRS providers").

[1621] *Interconnection Clarification Order*, 26 FCC Rcd at 8270, para. 21 & n.76.

[1622] *See, e.g.*, AAPC Petition at 4 (arguing that section 20.11(e) of the Commission's rules "was adopted without providing general notice of 'either the terms or substance of the proposed rule' in apparent disregard of the Administrative Procedures Act") (quoting 4 U.S.C. § 553(b)(3)).

[1623] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9642, para. 90.

[1624] *Id.* at 9641, para. 86.

[1625] *Comment Sought on Petitions for Declaratory Ruling Regarding Intercarrier Compensation for Wireless Traffic*, CC Docket No. 01-92, Public Notice, 17 FCC Rcd 19046 (2002); Intercarrier Compensation for Wireless Traffic, 67 Fed. Reg. 64,120 (Oct. 17, 2002) (publishing the Public Notice in the Federal Register). *See also* T-Mobile Opposition and Comments, CC Docket No. 01-92 at 7 (filed June 30, 2005) ("The Commission fully complied with [notice and comment] requirements by issuing a public notice seeking comment on the reciprocal compensation issues involving CMRS providers and incumbent LECs, as raised in the petition for declaratory ruling filed by T-Mobile and other parties. This public notice was subsequently published in the Federal Register and therefore satisfies the notice-and-comment requirements of the APA.") (footnotes omitted).

[1626] SBC Opposition, CC Docket No. 01-92, at 3 n.7 (filed June 30, 2005). *See also, e.g.*, Alabama Rural Local Exchange Carriers Reply, CC Docket No. 01-92 at 6 (filed Nov. 1, 2002) (The Commission should "revise its existing rules to make it clear that 'that CMRS providers have an affirmative obligation to negotiate and enter into interconnection compensation agreements with independent LECs' prior to terminating traffic to such LECs (continued…)

that parties lacked adequate notice and an opportunity to comment on the requirements ultimately imposed in section 20.11(e) of the Commission's rules.

c. Requests for Clarification

844. A number of petitions seek clarification regarding the operation of the *T-Mobile Order* and/or the state of the law that existed prior to such decision.[1627] Except insofar as discussed above,[1628] or in our actions regarding wireless intercarrier compensation generally,[1629] we decline to provide such clarification here. The Commission has discretion whether to issue a declaratory ruling, and rather than addressing these requests here, we can address issues as they arise.[1630]

d. Extending *T-Mobile* to Other Contexts

845. We decline, at this time, to extend the obligations enumerated in the *T-Mobile Order* to other contexts. As discussed above, the *T-Mobile Order* imposed on CMRS providers the duty to negotiate interconnection agreements with incumbent LECs under the section 252 framework.[1631] However, the *T-Mobile Order* did not address relationships involving competitive LECs or among other interconnecting service providers. Subsequently, competitive LECs have requested that the Commission expand the scope of the *T-Mobile Order* and require CMRS providers to negotiate agreements with competitive LECs under the section 251/252 framework, just as they do with incumbent LECs.[1632] In addition, rural incumbent LECs urged the Commission to "give small carriers some legal authority to demand a negotiated interconnection agreement," and argued that "the Commission should extend the *T-Mobile Order* to give ILECs the right to demand interconnection negotiations with all carriers."[1633] Policy and legal issues surrounding the possible extension of the *T-Mobile Order* are insufficiently addressed in our current record, and as such we seek comment in the accompanying FNPRM on whether to extend *T-Mobile Order* obligations to other contexts.[1634]

846. However, this issue remains highly relevant notwithstanding our adoption of bill-and-keep as the default for reciprocal compensation between LECs and CMRS providers under section

(Continued from previous page)

pursuant to arrangements with an RBOC.") (quoting Frontier and Citizens Comments, CC Docket 01-92, at 8 (filed Oct. 18, 2002).

[1627] *See, e.g.*, MetroPCS Petition; Missouri Small Telephone Company Group Petition for Reconsideration, CC Docket No. 01-92 (filed Mar. 25, 2005) (MoSTCG Petition); T-Mobile USA Petition for Clarification or, in the Alternative, Reconsideration, CC Docket No. 01-92 (filed Apr. 29, 2005).

[1628] *See supra* Section XII.C.5.b.

[1629] *See infra* Section XV.

[1630] *See* 47 C.F.R § 1.2; *Yale Broadcasting Co. v. FCC*, 478 F.2d 594, 602 (D.C. Cir. 1973) (Commission did not abuse its discretion by declining to grant a declaratory ruling).

[1631] *See supra* XII.C.5.

[1632] *See, e.g.*, Pac-West Comments at 3; PAETEC et al. Section XV Reply at 23-24; Letter from Michael B. Hazzard, counsel for Xspedius, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 7 (filed Aug. 10, 2005); Supra Telecommunications and Information Systems *Ex Parte* Comments and Cross-Petition for Limited Clarification, CC Docket No. 01-92 at 10 (filed July 14, 2005).

[1633] NECA et al. Section XV Comments at 29 n.67, 30.

[1634] *See infra* para. 1324

251(b)(5).[1635] Under a bill-and-keep methodology, carriers still will need to address issues such as the "edge" for defining the scope of bill-and-keep, subject to arbitration where they cannot reach agreement.[1636] These issues do not lend themselves well to one-size-fits-all approaches as would be required under a tariffing regime. Imposing a duty to negotiate, subject to arbitration, will negate the need for Commission intervention in this context and will facilitate more market-based solutions.[1637] Because we also maintain our existing requirements regarding interconnection and prohibitions on blocking traffic, our experience suggests that carriers under no legal compulsion to come to the table may have no incentive to do so, thus frustrating the efforts of interconnected carriers to resolve open questions. The section 252 framework—already in place in other contexts under the terms of the Act—may be a reasonable mechanism to use to address these situations.

XIII. RECOVERY MECHANISM

A. Introduction

847. In this section, we adopt a transitional recovery mechanism to facilitate incumbent LECs' gradual transition away from ICC revenues reduced as part of this Order. This mechanism allows LECs to recover ICC revenues reduced as part of our intercarrier compensation reforms, up to a defined baseline, from alternate revenue sources: incremental, and limited increases in end user rates and, where appropriate, universal service support through the Connect America Fund. The recovery mechanism is limited in time and carefully balances the benefits of certainty and a gradual transition with our goal of keeping the federal universal service fund on a budget and minimizing the overall burden on end users.

848. The recovery mechanism is not 100 percent revenue-neutral relative to today's revenues, but it eliminates much of the uncertainty carriers face under the existing ICC system, allowing them to make investment decisions based on a full understanding of their revenues from ICC for the next several years. Absent reform, price cap and rate-of-return carriers alike face an increasingly unpredictable revenue stream from ICC, which will only get worse as demand for traditional telephone service continues to decline. For price cap carriers, under the current system, access rates remain constant as demand declines, so declining MOUs have led to rapid and significant revenue declines. Rate-of-return carriers are experiencing similar declines in intrastate access revenues, because most states do not perform regular true ups of intrastate access rates to reflect declining demand. And while rate-of-return carriers' interstate access rates do increase today as demand declines, in theory holding their interstate access revenues constant, in practice the rapid decline in demand has caused large rate increases that incent other communications providers to develop and use access avoidance schemes.[1638] Such schemes, along with phantom traffic, uncertainty about payment for VoIP, and resulting litigation, have placed significant additional strain on the reliability of intercarrier compensation as a revenue stream for all types

[1635] *See supra* XV. We hold above that the mutual compensation owed for purposes of section 20.11 of the Commission's rules is coextensive with the reciprocal compensation requirements between LECs and CMRS providers, and we also adopt bill-and-keep as the default reciprocal compensation arrangement in this context. *See supra* XV.C. For convenience, this discussion uses the phrases "mutual compensation" and "reciprocal compensation" interchangeably, without prejudging the appropriate compensation level prior to this Order.

[1636] *See supra* Sections XII.A and XV.

[1637] *See, e.g.*, RNK Communications Section XV Comments at 8 (citing benefits that can arise from a framework that allows parties to negotiate mutually agreeable outcomes, rather than all parties being categorically bound to a single regime); Verizon Section XV Comments at 13-14 (same); Bandwidth.com Reply at 11, 15-17 (same).

[1638] *See, e.g.*, Letter from Jerry Weikle, ERTA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, at 1, 3 (filed July 8, 2011) (ERTA July 8, 2011 *Ex Parte* Letter)(describing arbitrage concerns with respect to Halo Wireless).

of carriers. These trends are only likely to accelerate as communication options for consumers continue to proliferate beyond landline telephone calling.

849. In establishing the framework for recovery, we conclude that carriers should first look to limited recovery from their own end users, consistent with the principle of bill and keep and the model in the wireless industry, and we take measures to ensure that phone rates remain affordable and reasonably comparable among all Americans. Therefore, we adopt several safeguards to protect end users from unreasonable or excessive increases, for example by adopting a Residential Rate Ceiling above which consumer recovery through a federal Access Recovery Charge (ARC) is prohibited, and significantly mitigating ICC recovery from residential consumers by balancing it with recovery from multi-line businesses. We also adopt protections to ensure that multiline businesses do not see any unreasonable increases by adopting a per-line total cap that includes both the federal SLC and the new federal ARC. Additional recovery, when permitted, will be provided from the CAF. We also adopt safeguards to ensure USF stays within our budget and to ensure that CAF ICC support serves to advance our goal of universal voice and broadband, creating significant consumer benefits. We note that, during the transition adopted in this Order, all LECs will continue to collect intercarrier compensation for originating access and dedicated transport, providing continued revenue flows from those sources.

B. Summary

850. Our recovery mechanism has two basic components. First, we define the revenue incumbent LECs are eligible to recover, which we refer to as "Eligible Recovery." Second, we specify how incumbent LECs may recover Eligible Recovery through limited end-user charges and, where eligible and a carrier elects to receive it, CAF support. Competitive LECs are free to recover reduced revenues through end-user charges.

851. *Eligible Recovery.*

- Price cap incumbent LECs' Baseline for recovery will be 90 percent of their Fiscal Year 2011 (FY2011)[1639] interstate and intrastate access revenues for the rates subject to reform and net reciprocal compensation revenues. For price cap carriers' study areas that participated in the Commission's 2000 *CALLS* reforms, and thus have had interstate access rates essentially frozen for almost a decade, Price Cap Eligible Recovery (i.e., revenues subject to our recovery mechanism) will be the difference between: (a) the Price Cap Baseline, subject to 10 percent annual reductions; and (b) the revenues from the reformed intercarrier compensation rates in that year, based on estimated MOUs multiplied by the associated default rate for that year. For carriers that have more recently converted to price cap regulation and did not participate in the *CALLS* plan, we phase in the reductions after five years, so that the initial 10 percent reduction occurs in year six. Estimated MOUs will be calculated as FY2011 minutes for all price cap carriers, and will be reduced 10 percent annually for each year of reform to reflect MOU trends over the past several years. Because such demand reductions have applied equally to all price cap carriers, we do not make any distinction among price cap carriers for purposes of this calculation. We adopt this straight line approach to determining MOUs, rather than requiring carriers to report actual minutes each year, because it will be more predictable for carriers and less burdensome to administer.
- Rate-of-return incumbent LECs' Baseline for recovery, which is somewhat more complex, will be based on their 2011 interstate switched access revenue requirement (which is recovered today through interstate access revenues and local switching support (LSS), if

[1639] We define "fiscal year" 2011 for these purposes as October 1, 2010 through September 30, 2011.

applicable), plus FY2011 intrastate terminating switched access revenues and FY2011 net reciprocal compensation revenue. Rate-of-Return Eligible Recovery will be the difference between: (a) the Rate-of-Return Baseline, subject to five percent annual reductions; and (b) the revenues from the reformed intercarrier compensation rates in that year, based on actual MOUs multiplied by the associated default rate for that year. The annual Rate-of-Return Baseline reduction used in the calculation of Rate-of-Return Eligible Recovery revenue reflects two considerations. First, in recent years rate-of-return carriers' interstate switched access revenue requirements have been declining on average at approximately three percent annually due to declining regulated costs, with corresponding declines in interstate access revenues; such declines are projected to continue each year for the next several years.[1640] In addition, rate-of-return carriers' intrastate revenues have been declining on average at 10 percent per year as MOU decline,[1641] with state regulatory systems that typically do not have annual, automatic mechanisms to increase rates to account for declining demand. Weighing these considerations, we find it appropriate to reduce rate-of-return carriers' Eligible Recovery by five percent annually.[1642] This approach to revenue recovery will put most rate-of-return carriers in a better financial position—and will provide substantially more certainty—than the *status quo* path absent reform, where MOU declines would continue to be large and unpredictable and would significantly reduce intrastate revenues. This approach also provides carriers with the benefit of any costs savings and efficiencies they can achieve by enabling carriers to retain revenues even if their switched access costs decline. And it avoids creating misaligned incentives for carriers to inefficiently increase costs to grow their intercarrier compensation revenue requirement and thereby draw more access replacement from the CAF.

852. *Recovery from End Users*. Consistent with past ICC reforms, we permit carriers to recover a limited portion of their Eligible Recovery from their end users through a monthly fixed charge called an ARC. We take measures to ensure that any ARC increase on consumers does not impact affordability of rates, including by limiting the annual increase in consumer ARCs to $0.50. We also make clear that carriers may not charge an ARC on any Lifeline customers.[1643] This charge is calculated independently from, and has no bearing on, existing SLCs, although for administrative and billing efficiencies we do permit carriers to combine the charges as a single line item on a bill.

[1640] *See* Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at Attach. 3 at 1 (filed Sept. 9, 2011) (NTCA Sept. 9, 2011 *Ex Parte* Letter).

[1641] *See generally* Letter from Regina McNeil, VP of Legal, General Counsel & Corporate Secretary, NECA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket No. 01-92 (filed April 6, 2011); Letter from Regina McNeil, VP of Legal, General Counsel & Corporate Secretary, NECA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket No. 01-92 (filed May 11, 2011); Letter from Regina McNeil, VP of Legal, General Counsel & Corporate Secretary, NECA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket No. 01-92 (filed May 25, 2011) (collectively *NECA Data Filings*) (based upon aggregation of confidential data).

[1642] We seek comment in the FNPRM asking whether we should change this reduction after five years by either moving to a decline based on MOUs and/or increasing the decline by one percent per year up to a maximum of 10 percent annual baseline decline. *See supra para.* 1329.

[1643] *See, e.g.*, Letter from Chris Riley, Policy Counsel, Free Press, to Marlene H. Dortch, Secretary, FCC, WT Docket No. 11-65, WC Docket Nos. 10-90, 05-337, 03-109, 11-42, GN Docket No. 09-51, CC Docket Nos. 01-92 at 1 (filed Oct. 14, 2011) (urging the Commission to exclude any Lifeline customers from any recovery charge adopted as part of ICC reform).

- *Recovery Fairly Balanced Across All End Users.* We do not, as some commenters urge, put the entire burden of access recovery on consumers. Rather, consistent with the Commission's approach in past reforms, under which business customers also contributed to offset declines in access charges, we balance consumer and single-line business recovery with recovery from multi-line businesses. We also adopt additional measures to protect consumers of incumbent LECs that elect not to receive CAF funding, by limiting the proportion of Eligible Recovery that can come from consumers and single-line businesses based on a weighted share of a carrier's residential versus business lines.[1644]
- *Protections for Consumers Already Paying Rebalanced Rates.* To protect consumers, including in states that have already rebalanced rates through prior state intercarrier compensation reforms, we adopt a Residential Rate Ceiling that prohibits imposing an ARC on any consumer paying an inclusive local monthly phone rate of $30 or more.[1645]
- *Protections for Multi-Line Businesses.* Although we do not adopt a business rate ceiling, nor were there proposals in the record to do so, we do take measures to ensure that multi-line businesses' total SLC plus ARC line items are just and reasonable. The current multi-line business SLC is capped at $9.20. Some carriers, particularly smaller rate of return and mid-size carriers, are at or near the cap, while larger price cap carriers may have business SLCs as low as $5.00. To minimize the burden on multi-line businesses, we do not permit LECs to charge a multi-line business ARC where the SLC plus ARC would exceed $12.20 per line. This limits the ARC for multi-line businesses for entities at the current $9.20 cap to $3.00. We find this limitation for multi-line businesses consistent with the reasons we place an overall limit on the residential ARCs discussed below.
- To recover Eligible Recovery, price cap incumbent LECs are permitted to implement monthly end user ARCs with five annual increases of no more than $0.50 for residential/single-line business consumers, for a total monthly ARC of no more than $2.50 in the fifth year; and $1.00 (per month) per line for multi-line business customers, for a total of $5.00 per line in the fifth year, provided that: (1) any such residential increases would not result in regulated residential end-user rates that exceed the $30 Residential Rate Ceiling; and (2) any multi-line business customer's total SLC plus ARC does not exceed $12.20. The monthly ARC that could be charged to any particular consumer cannot increase by more than $0.50 annually, and in fact we estimate that the average increase in the monthly ARC that would be permitted across all consumer lines over the period of reform, based on the amount of eligible recovery, is approximately $0.20 annually.[1646] However, we expect that not all

[1644] This limitation is only necessary for carriers that are not eligible or elect not to receive CAF funding because carriers recovering from CAF will have the full ARC imputed to them.

[1645] The Residential Rate Ceiling is based on the state basic local residential service rate plus the federal SLC and the ARC; the flat rate for residential local service, mandatory extended area service charges, and state subscriber line charges; per-line state high cost and/or access replacement universal service contributions; state E911 charges; and state TRS charges. *See infra* paras. 913-916.

[1646] FCC Staff Analysis. Using incumbent LECs' filings in this docket, staff totaled each LECs' access revenues that are being reduced as a result of this Order, and then converted these aggregate dollar figures into a per line amount by dividing by the carrier's average lines in service for the most recent filing period. *See* Letter from Karen Brinkmann, Counsel to Alaska Communications Systems, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed Sept. 7, 2011); Letter from Karen Brinkmann, Counsel to Hawaiian Telecom, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed June 24, 2011); Letter from Karen Brinkmann, Counsel to Fairpoint, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. (continued...)

carriers will elect or be able to charge the ARC due in part to competitive pressures, and we therefore predict the average actual increase across all consumers to be approximately $0.10-$0.15 each year, peaking at approximately $0.50 to $0.90 after five or six years, and declining thereafter.[1647]

- To recover Eligible Recovery, rate-of-return incumbent LECs are permitted to implement monthly end user ARCs with six annual increases of no more than $0.50 (per month) for

(Continued from previous page)

09-51 at Attach. (filed Apr. 19, 2011); Letter from Maggie McCready, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at 2 (filed Apr. 14, 2011); Letter from Christopher Heimann, General Attorney, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed Apr. 8, 2011); Letter from Maggie McCready, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Ex. 1 (filed Mar. 24, 2011); Letter from Maggie McCready, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Ex. 1 (filed Mar. 14, 2011); Letter from Melissa Newman, Vice President-Federal Relations, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at Attach. (filed Jan. 18, 2011); CenturyLink, Response to FCC Data Request, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 (filed Jan. 13, 2011); Letter from Michael D. Saperstein, Jr., Director of Federal Regulatory Affairs, Frontier, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed Dec. 16, 2010); Letter from Malena Barzilai, Regulatory Counsel & Director – Federal Regulatory Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed Oct. 15, 2010) (collectively *ILEC Data Filings*) (collectively, *ILEC Data Filings*); *see also*, Letter from Regina McNeil, Vice President of Legal, General Counsel and Corporate Secretary, NECA, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed May 25, 2011); Letter from Regina McNeil, Vice President of Legal, General Counsel and Corporate Secretary, NECA, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed May 11, 2011); Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 80-286 at Attach. (filed Dec. 29, 2010). Staff then trended this value over the period of reform to reflect the excess MOU loss over expected line loss (annual declines of 10 percent and 7.5 percent respectively), and applied the appropriate reduction to eligible recovery. This produced the approximate total recovery need per line for the carrier over the course of reform. Staff then divided this value by the number of ARC increases (5 for price cap, 6 for rate of return) to get an average ARC increase across all lines. Staff then adjusted this average based on each carrier's mix of residential and single line businesses to multiline businesses and the carrier's potential annual ARC increases, factoring in the annual caps of $1.00 and $1.00 on consumers and multiline businesses respectively, the residential ceiling of $30 and the business ARC + SLC limit of $12.20 and the exclusion of Lifeline lines, to estimate the average imputed consumer ARC increase.

[1647] To estimate likely actual consumer ARC increase, staff applied a 25-50 percent reduction factor to the theoretically permitted ARCs to reflect our expectation that competitive pressures will prevent carriers from imposing the full charges on all consumers. Filings in the record support our prediction that carriers will not charge the maximum permitted ARCs on all customers. *See, e.g.,* Reply Comments of AT&T Inc. on the Missoula Plan for Intercarrier Compensation Reform, CC Docket No. 01-92, filed Feb. 1, 2007, Exhibit 1 at n. 11. *See also* http://www.phoenix-center.org/perspectives/Perspective11-06Final.pdf (suggesting carriers would realize as little as 40 percent ARC recovery). We recognize that these estimates are necessarily predictive and imprecise, however, and we believe any burden on consumers will be significantly outweighed by the benefits of reform even if carriers are able to charge the full permitted ARCs.

residential/single-line business consumers, for a total ARC of no more than $3.00 in the sixth year; and $1.00 (per month) per line for multi-line business customers for a total of $6.00 per line in the sixth year, provided that: (1) such increases would not result in regulated residential end-user rates that exceed the $30 Residential Rate Ceiling; and (2) any multi-line business customer's total SLC plus ARC does not exceed $12.20.

- Competitive LECs, which are not subject to the Commission's end-user rate regulations today, may recover reduced intercarrier revenues through end-user charges.

853. *Explicit Support from the Connect America Fund.* The Commission has recognized that some areas are uneconomic to serve absent implicit or explicit support. ICC revenues have traditionally been a means of having other carriers (who are now often competitors) implicitly support the costs of the local network. As we continue the transition from implicit to explicit support that the Commission began in 1997, recovery from the CAF for incumbent LECs will be provided to the extent their Eligible Recovery exceeds their permitted ARCs. For price cap carriers that elect to receive CAF support, such support is transitional, phasing out over three years beginning in 2017. This phase out reflects, in part, the fact that such carriers will be receiving additional universal service support from the CAF that will phase in over time and is designed to reflect the efficient costs of providing service over a voice and broadband network. For rate-of-return carriers, ICC-replacement CAF support will phase down as Eligible Recovery decreases over time, but will not be subject to other reductions.

- All incumbent LECs that elect to receive CAF support as part of this recovery mechanism will be subject to the same accountability and oversight requirements adopted in Section VIII above. For rate-of-return carriers, the obligations for deploying broadband upon reasonable request specified in the CAF section above apply as a condition of receiving ICC-replacement CAF.[1648] For price cap carriers that elect to receive ICC-replacement CAF support, we require such support be used for building and operating broadband-capable networks used to offer their own retail service in areas substantially unserved by an unsubsidized competitor[1649] of fixed voice and broadband services. Thus, all CAF support will directly advance broadband deployment. This approach is consistent with carriers' representations that they currently use ICC revenues for broadband deployment.[1650]
- Competitive LECs, which have greater freedom in setting rates and determining which customers they wish to serve, will not be eligible for CAF support to replace reductions in ICC revenues.[1651]

C. Policy Approach to Recovery

854. As discussed above, our reforms seek to enable more widespread deployment of broadband networks, to foster the transition to IP networks, and to reduce marketplace distortions. We recognize that this transition affects different—but overlapping—segments of consumers in different ways. We therefore seek to adopt a balanced approach to reform that benefits consumers as a whole.

[1648] These are the same obligations, including latency, speed and usage levels, adopted for rate-of-return legacy high-cost funding adopted above. *See supra* Section VI.

[1649] *Supra* para. 103.

[1650] *See, e.g.*, CenturyLink *USF/ICC Transformation NPRM* Comments at 50; Nebraska Rural Independent Companies *USF/ICC Transformation NPRM* Comments at 25; USTelecom *USF/ICC Transformation NPRM* Comments at 3.

[1651] We are not abrogating agreements in this Order, but observe that agreements may have relevant change of law provisions. *See supra* para. 815.

855. The overall reforms adopted in this Order will enable expanded build-out of broadband and advanced mobile services to millions of consumers in rural America who do not currently have broadband service. Our ICC reforms will fuel new investment by making incumbent LECs' revenue more predictable and certain. Indeed, incumbent LECs receiving CAF support as part of this recovery mechanism will have broadband deployment obligations.

856. In addition, as discussed above, we anticipate that reductions in intercarrier compensation charges will result in reduced prices for network usage, thereby enabling more customers to use unlimited all-distance service plans or plans with a larger volume of long distance minutes, and also leading to increased investment and innovation in communications networks and services.[1652] Moreover, consistent with previous ICC reforms, which gave rise to substantial benefits from lower long distance prices, we expect consumers to realize substantial benefits from this reform. This is especially true for customers of carriers for which intercarrier compensation charges historically have been a significant cost, such as wireless providers and long distance carriers.[1653]

857. Today, carriers receive payments from other carriers for carrying traffic on their networks at rates that are based on recovering the average cost of the network, plus expenses, common costs, overhead, and profits, which together far exceed the incremental costs of carrying such traffic. The excess of the payments over the associated costs constitutes an implicit annual subsidy of local phone networks—a subsidy paid by consumers and businesses everywhere in the country. This distorts competition, placing actual and potential competitors that do not receive these same subsidies at a market disadvantage, and denying customers the benefits of competitive entry.

858. As we pursue the benefits of reforming this system, we also seek to ensure that our transition to a reformed intercarrier compensation and universal service system does not undermine continued network investment—and thus harm consumers. Consequently, our recovery mechanism is designed to provide predictability to incumbent carriers that had been receiving implicit ICC subsidies, to mitigate marketplace disruption during the reform transition, and to ensure our intercarrier compensation reforms do not unintentionally undermine our objectives for universal service reform. As the State Members observe, for example, "[b]ankers and equity investors need to be able to see that both past and future investments will be backed by long-term support programs that are predictable."[1654] Similarly, they

[1652] An example of lower usage prices is lower per-minute prices within a bundle of cell-phone minutes (*e.g.*, through larger numbers of minutes being added to the bundle). *See, e.g.*, *supra* Section XII.A.1.

[1653] *See supra* Section XII.A.1. In addition, economists have estimated that above-cost access charges reduced U.S. economic welfare by an estimated $10–17 billion annually during the late 1980s, but that the annual welfare loss declined substantially to between $2.5 billion and $7 billion following the Commission's access charge reforms in the 1980s and early 1990s. *See* Letter from Jerry Ellig, Senior Research Fellow, Mercatus Center, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 08-183, 07-135, 05-337, 99-68 at 2 (filed Sept. 22, 2008) (citing Robert W. Crandall, AFTER THE BREAKUP: U.S. TELECOMMUNICATIONS IN A MORE COMPETITIVE ERA 141 (1991) and Robert W. Crandall & Leonard Waverman, WHO PAYS FOR UNIVERSAL SERVICE? 120 (2000)).

[1654] State Members *USF/ICC Transformation NPRM* Comments at 5; *see also, e.g.*, Kansas Commission *USF/ICC Transformation NPRM* Comments at 3; Louisiana PSC *August 3 PN* Comments at 4; Verizon Section XV Reply at 19-20 (quoting Rebecca Arbogast et al., Stifel Nicolaus, *FCC Looks To Shift USF-ICC Reform Drive into Overdrive; August Order Eyed*, at 1 (Mar. 15, 2011)); FCC Universal Service Fund and Intercarrier Compensation Workshop, April 6, 2011, CC Docket No. 01-92 at 96-97, transcript *available at* http://www.fcc.gov/events/universal-service-fundintercarrier-compensation-reform-workshop.

note that "abrupt changes in support levels can harm consumers."[1655] Predictable recovery during the intercarrier compensation reform transition is particularly important to ensure that carriers "can maintain/enhance their networks while still offering service to end-users at reasonable rates."[1656] Providing this stability does not require revenue neutrality, however.

859. Ultimately, consumers bear the burden of the inefficiencies and misaligned incentives of the current ICC system, and they are the ultimate beneficiaries of ICC reform. In structuring a reasonable transition path for ICC reform, we seek to balance fairly the burdens borne by various categories of end users, including consumers already paying high residential phone rates, consumers paying artificially low residential phone rates, and consumers that contribute to the universal service fund. Given nationwide disparities in local rates, it would be unfair to place the entire burden of the ICC transition on USF contributors. Just as the Commission has undertaken some intercarrier compensation reforms since the 1996 Act, shifting away from implicit intercarrier subsidies to end-user charges and universal service for recovery, some states have done so, as well. For example, Alaska has recently reformed its intrastate access system, establishing a Network Access Fee of $5.75, and increasing the role of the Alaska USF in subsidizing carriers' intrastate revenues with a state USF surcharge of 9.4 percent.[1657] Similarly, in Wyoming, which has also rebalanced rates, many rural customers face total charges for basic residential phone service in excess of $40 per month.[1658] The Nebraska Companies note total out-of-pocket local residential rates in that state already exceed $30 per month and should not be increased under any federal reforms contemplated by the Commission.[1659] Were we to place the entire burden of ICC recovery on USF contributors, not only would consumers in each of these states be forced to contribute more, but USF, which is also supported through consumer contributions, could not stay within the budget discussed in Section VII.B above. Meanwhile, as discussed above, other states have retained high intrastate intercarrier compensation rates to subsidize artificially low local rates—including some as low as $5 per month—effectively shifting the costs of those local networks to long distance and wireless customers across the country.[1660] In this context, we find it reasonable to allow carriers to seek some recovery from their own customers, subject to protection for consumers already paying rates for local phone service at or near $30 per month. We also prevent carriers from charging an ARC on any Lifeline customers. We also protect consumers by limiting any increases in consumer ARCs based upon actual or imputed increases in ARCs for business customers.

860. Some commenters argue that a variety of other regulatory considerations should alter the Commission's approach to recovery. For example, some express concerns about the level of existing federal subscriber line charges (SLCs) and special access rates and the extent to which carriers use the ratepayer- and universal service-funded local network to provide unregulated services.[1661] Although we

[1655] State Members *USF/ICC Transformation NPRM* Comments at 5-6; *see also, e.g.*, Michigan PSC *USF/ICC Transformation NPRM* Comments at 18.

[1656] Michigan PSC *USF/ICC Transformation NPRM* Reply at 10. *See also, e.g.*, Louisiana PSC *August 3 PN* Comments at 3-4.

[1657] Alaska Regulatory Commission *USF/ICC Transformation NPRM* Comments at 26-27.

[1658] Wyoming PSC *USF/ICC Transformation NPRM* Reply at 5.

[1659] Nebraska Rural Independent Companies *USF/ICC Transformation NPRM* Comments at 30 n.45 ("with the local rate benchmarks required under the Nebraska USF program along with subscriber line charge and other surcharges, total out-of-pocket local residential rates in the state already exceed $30 per month").

[1660] *See supra* Section VII.D.5.

[1661] *See, e.g.*, Free Press *August 3 PN* Comments at 10; NASUCA *August 3 PN* Comments at 62-63.

address certain of those issues below, we are not persuaded that we should delay comprehensive intercarrier compensation and universal reform pending resolution of those outstanding questions, given the urgency of advancing the country's broadband goals. Nor do we treat those issues as a static, unchanging backdrop to the reforms we adopt here. In the FNPRM below we reevaluate existing SLCs, including by seeking comment on whether SLCs today are set at an excessive level and should be reduced.[1662] To attempt to account for these concerns through reduced recovery here, particularly given potential changes that the Commission might consider, would unduly complicate—and significantly delay—badly needed reform that we believe will result in significant consumer benefits. Consequently, we believe that the consumer protections incorporated in our recovery mechanism and the transitional nature of the recovery strike the right balance for consumers as a whole.

861. Although the preceding has been focused on the substantial benefits of our reform to consumers, in crafting these reforms we also took account of costs and benefits to industry. Our reforms are minimally burdensome to carriers, imposing only minor incremental costs (i.e., costs that would not be otherwise incurred without our reforms). The incremental costs of reform arise primarily from implementation, meaning that they are one-time costs of the transition that are not incurred on an ongoing basis. Further, these costs are heavily outweighed by efficiency benefits that carriers, as well as other industry participants and consumers, will experience. For carriers as well as end users, these benefits include significantly more efficient interconnection arrangements. Carriers will provide existing services more efficiently, make better pricing decisions for those services, and innovate more efficiently. Carriers' incentives to engage in inefficient arbitrage will also be reduced, and carriers will face lower costs of metering, billing, recovery, and disputes related to intercarrier compensation. Further, carriers, firms more generally, and consumers, facing more efficient prices for voice services, will make more use of voice services to greater effect, and more efficient innovation will result. In contrast to the transitional, one-time costs of reform, these efficiency benefits are ongoing and will compound over time.

D. Carriers Eligible To Participate in the Recovery Mechanism

862. The Commission sought comment in the *USF/ICC Transformation NPRM* on whether recovery should be limited to certain carriers, or whether it should extend more broadly to all LECs.[1663] We extend the recovery mechanisms adopted in this Order to all incumbent LECs because regulatory constraints on their pricing and service requirements otherwise limit their ability to recover their costs.[1664]

[1662] One commenter states that "the Commission concluded that approximately 82 percent of residential and single-line business price-cap lines had forward-looking costs below $6.50." Free Press *USF/ICC Transformation NPRM* Comments at 7. In fact, rather than endorsing that cost estimate, the Commission concluded that "even the most conservative estimate of forward-looking costs" for price cap carriers "shows that [the cost of] a substantial number of lines exceeds both the current $5.00 SLC cap, and the ultimate $6.50 SLC cap." *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10871-72 para. 5 (2002). Notwithstanding that distinction, however, we find it appropriate to take a fresh look not only at whether SLCs are set at appropriate levels under existing regulations, but, longer term, whether such charges should be retained at all. *See infra* Section XVII.O.

[1663] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732-33, para. 571. *See also, e.g., 2008 USF/ICC FNPRM*, 24 FCC Rcd at 6632, 6637-39 App. A, paras. 302, 318-19; *2005 Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4706, 4709-10, 4732, paras. 43, 50, 51, 104.

[1664] If an incumbent LEC receives recovery of any costs or revenues that are already being recovered as Eligible Recovery through ARCs or the CAF, that LEC's ability to recover reduced switched access revenue from ARCs or the CAF shall be reduced to the extent it receives duplicative recovery. Incumbent LECs seeking revenue recovery will be required to certify as part of their tariff filings to both the FCC and to any state commission exercising jurisdiction over the incumbent LEC's intrastate costs that the incumbent LEC is not seeking duplicative recovery in (continued...)

All incumbent LECs have built out their networks subject to COLR obligations, supported in part by ongoing intercarrier compensation revenues.[1665] Thus, incumbent LECs have limited control over the areas or customers that they serve, having been required to deploy their network in areas where there was no business case to do so absent subsidies, including the implicit subsidies from intercarrier compensation. At the same time, incumbent LECs generally are subject to more statutory and regulatory constraints than other providers in the retail pricing of their local telephone service.[1666] Thus, incumbent LECs are limited in their ability to increase rates to their local telephone service customers as a whole to offset reduced implicit subsidies.

863. Proposals to limit the recovery mechanism to only some classes of incumbent LECs, such as rate-of-return carriers,[1667] neglect these considerations, and in particular ignore that price cap incumbent LECs typically are also subject to regulatory constraints on end-user charges. We do, however, recognize the differences faced by price cap and rate-of-return carriers under the *status quo* absent reform, and therefore adopt different recovery mechanisms for price cap and rate-of-return carriers, as explained below.

864. *Competitive LECs.* We decline to provide an explicit recovery mechanism for competitive LECs.[1668] Unlike incumbent LECs, because competitive carriers have generally been found to lack market power in the provision of telecommunications services,[1669] their end-user charges are not subject to comparable rate regulation,[1670] and therefore those carriers are free to recover reduced access

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the state jurisdiction for any Eligible Recovery subject to the recovery mechanism. To monitor and ensure that this does not occur, we require carriers participating in the recovery mechanism, whether ARC and/or CAF, to file data annually. *See infra* paras. 921-923.

[1665] *See, e.g.*, CenturyLink *USF/ICC Transformation NPRM* Comments at 3, 9; SureWest *USF/ICC Transformation NPRM* Comments at 10; Pend Orielle *USF/ICC Transformation NPRM* Comments at 7; Windstream Aug. 21, 2008 Comments, CC Docket Nos. 94-68, 01-92, 96-45; WC Docket Nos. 08-152, 07-135, 04-36, 06-122, 05-337, 99-68 at 7.

[1666] This includes both Commission regulation of the federal SLC and, frequently, state regulation of retail local telephone service rates as well.

[1667] *See, e.g.*, NCTA *USF/ICC Transformation NPRM* Reply at 8 ("Any access replacement support should be limited to a very small number of truly rural providers that are subject to rate-of-return regulation, and should not be available to make all incumbent LECs whole for every dollar of access charge revenue that is eliminated").

[1668] CMRS providers generally do not collect access charges for originating or terminating calls on their networks. As they will generally not be losing access revenue and will see the elimination of most terminating access charges, they are not entitled to recovery from the recovery mechanism. *See generally USF/ICC Transformation NPRM*, 26 FCC Rcd at 4718 n.787.

[1669] *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923, at 9926, para. 8 (2001) (*CLEC Access Charge Order*) ("Competitive entrants into the exchange access market have historically been subject to our tariff rules, but have been largely free of the other regulations applicable to incumbent LECs.") (citations omitted).

[1670] For instance, the Commission has declined to regulate the SLCs of competitive LECs. *See Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10870 n.8 (2002) (subsequent history omitted); *see also CLEC Access Charge Order*, 16 FCC Rcd at 9955, para. 81 (stating that competitive LECs competing with CALLS incumbent LECs are free to build into their end-user rates a component equivalent to the incumbent LEC's SLC).

revenue through regular end-user charges.[1671] Some competitive LECs have argued that their rates are constrained by incumbent LEC rates (as supplemented by regulated end-user charges and CAF support);[1672] to the extent this is true, we would expect this competition to constrain incumbent LECs' ability to rely on end-user recovery as well. Moreover, competitive LECs typically have not built out their networks subject to COLR obligations requiring the provision of service when no other provider will do so,[1673] and thus typically can elect whether to enter a service area and/or to serve particular classes of customers (such as residential customers) depending upon whether it is profitable to do so without subsidy.

865. In light of those considerations, we disagree with parties that advocate making the recovery mechanism we adopt today available to all carriers, both incumbent and competitive, or to all carriers that currently receive access charge revenues.[1674] Competitive LECs are free to choose where and how they provide service, and their ability to recover costs from their customers is generally not as limited by statute or regulation as it is for incumbent LECs.[1675]

866. We likewise decline to permit competitive LECs to reduce their access rates over a longer period of time than incumbent LECs. Instead, we believe that the approach adopted in the *CLEC Access Charge Order*, under which competitive LECs benchmark access rates to incumbent LECs' rates, is the better approach.[1676] That benchmarking rule was designed as a tool to constrain competitive LECs' access rates to just and reasonable levels without the need for extensive, ongoing accounting oversight and detailed evaluation of competitive LECs' costs.[1677] Deviating from that framework for purposes of the access reform transition would create new opportunities for arbitrage and require increased regulatory oversight, notwithstanding the fact that competitive LECs' access rates under the *CLEC Access Charge*

[1671] Although some competitive LECs assert that their contracts with business customers would not readily allow them to change intercarrier compensation rates under those contracts in the event of intercarrier compensation reform, *see, e.g.*, TDS Metrocom *August 3 PN* Reply at 6, those contracts reflect decisions made against the backdrop of possible intercarrier compensation reforms being contemplated by the Commission.

[1672] *See e.g.*, EarthLink *USF/ICC Transformation NPRM* Comments at 11 ("Even where EarthLink has the ability to modify rates, it may be prevented from increasing such rates because of competitive constraints (e.g., the incumbent against who EarthLink competes may not raise rates either because it is vertically integrated and its access charge savings offset its loses or it recovers a portion of its lost access revenue from a USF revenue recovery mechanism).").

[1673] See *supra* paras. 82-83.

[1674] *See, e.g.*, XO *USF/ICC Transformation NPRM* Comments at 50; Verizon and Verizon Wireless *USF/ICC Transformation NPRM* Comments at 50 ("All of these . . . proposed mechanisms, are designed to do the same thing—to give carriers a soft landing following reductions in ICC rates. All should be treated alike."); COMPTEL *USF/ICC Transformation NPRM* Comments at 37; PacWest *USF/ICC Transformation NPRM* Comments at 9; SouthEast Telephone *USF/ICC Transformation NPRM* Comments at 5; Letter from Bill Wade, General Manager, Mid-Rivers Communications, to Julius Genachowski, Chairman, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 1-4 (filed Oct. 17, 2011).

[1675] *See, e.g.*, ITTA *USF/ICC Transformation NPRM* Comments at vi ("[C]ompetitors without COLR obligations have defined their own service areas in a manner that allows them to serve only the lowest-cost customers in an area.").

[1676] *See generally CLEC Access Charge Order*; *see, also* Letter from Karen Reidy, COMPTEL, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket No. 01-92, 96-45, GN Docket No. 09-51, at 3 (filed July 27, 2011).

[1677] *CLEC Access Charge Order*, 16 FCC Rcd at 9924, para. 2.

Order were not based on any demonstrated level of need associated with those carriers' networks or operations. Nor has any commenter provided sufficient evidence to warrant departure from the benchmarking approach in this context. We therefore decline to adopt a separate transition path for competitive LECs. Rather, consistent with the general benchmarking rule that had been used for interstate access service, competitive LECs will benchmark to the default rates of the incumbent LEC in the area they serve as specified under this Order.

E. Determining Eligible Recovery

867. The first step in our recovery mechanism is defining the amount, called "Eligible Recovery," that incumbent LECs will be given the opportunity to recover.

1. Establishing the Price Cap Baseline

868. *Costs vs. Revenues.* The *USF/ICC Transformation NPRM* sought comment on whether, in adopting a recovery mechanism, the Commission should base recovery on carrier costs, carrier revenues, or some combination thereof.[1678] For the reasons set forth below, for price cap carriers, we will provide recovery based upon Fiscal Year 2011 ("FY2011" or "Baseline")[1679] access revenues that are reduced as part of the reforms we adopt today, plus FY2011 net reciprocal compensation revenues. Selecting FY2011 ensures that gaming or any disputes or nonpayment that may occur after the release of the Order does not impact carriers' Baseline revenues. For rate-of-return carriers, we adopt a bifurcated approach based on: (1) their 2011 interstate switched access revenue requirement;[1680] and (2) their FY2011 intrastate switched access revenues for services with rates to be reduced as part of the reforms we adopt today, plus FY2011 net reciprocal compensation revenues. Carriers have not demonstrated here that the existing intercarrier compensation revenues that we use as part of our Baseline calculations are

[1678] AT&T *USF/ICC Transformation NPRM* Comments at 4730, para. 564, citing National Broadband Plan at 148.

[1679] We will use Fiscal Year 2011 (i.e., October 1, 2010 through September 30, 2011) data to allow carriers a reasonable amount of time to collect the data necessary for implementation of these reforms. We chose to use a full 12-month period, rather than, for example, annualizing a portion of 2011 data, to ensure that carriers with seasonal calling patterns are not disproportionately affected. *See, e.g.*, Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration, CC Docket Nos. 00-218, 00-251, Memorandum Opinion and Order, 18 FCC Rcd 17722, 17866, para. 366 & n.958 (Wir. Comp. Bur. 2003) (discussing seasonal variation in traffic and noting, for example, that "[r]esort communities typically experience upwards of 60-75 percent of their total annual traffic during a 2 or 3 month vacation period"). We note that, because annual USF funding is not as subject to the same seasonal variance as are calling patterns, we use annualized figures for certain CAF purposes in this Order.

[1680] For a rate-of-return carrier that participated in the NECA 2011 annual switched access tariff filing, its 2011 interstate switched access revenue requirement will be its projected interstate switched access revenue requirement associated with the NECA 2011 annual interstate switched access tariff filing. For a rate-of-return carrier subject to section 61.38 of the Commission's rules that filed its own annual access tariff in 2010 and did not participate in the NECA 2011 annual switched access tariff filing, its 2011 interstate switched access revenue requirement will be its projected interstate switched access revenue requirement in its 2010 annual interstate switched access tariff filing. For a rate-of-return carrier subject to section 61.39 of the Commission's rules that filed its own annual switched access tariff in 2011, its revenue requirement will be its historically-determined annual interstate switched access revenue requirement filed with its 2011 annual interstate switched access tariff filing.

confiscatory or otherwise unjustly or unreasonably low,[1681] and we thus find them to be an appropriate starting point for our calculations under the recovery mechanism.[1682]

869. We conclude that, where the Commission lacks data, it is preferable to rely on revenues for determining recovery, as most commenters suggest.[1683] Defining carriers' costs today would be a burdensome undertaking that could significantly delay implementation of ICC reform. "Cost" would first have to be defined for these purposes, which is a difficult and time-consuming exercise. Indeed, price cap carriers' access charges are not based on current costs,[1684] and reliable cost information is not readily available.[1685] It is not clear that a reliable cost study based on current network configuration could be completed without undue delay,[1686] and doing so could be a complicated, time consuming, and expensive process, nor is it clear that a regulatory proceeding could come up with a definition of "cost" appropriate for recovery that is any better than the revenues approach we adopt today.

870. Moreover, the Commission has long recognized that intercarrier compensation rates include an implicit subsidy because they are set to recover the cost of the entire local network, rather than the actual incremental cost of terminating or originating another call. Given our commitment to a gradual transition with no flash cuts, our focus on revenues is appropriate to ensure carriers have a measured transition away from this implicit support on which they have been permitted to rely for many years.

871. For rate-of-return carriers, however, interstate switched access rates today are determined based on their interstate switched access revenue requirement, which is calculated in a manner that includes their "regulated interstate switched access costs" as the Commission has historically defined them, plus a prescribed rate of return on the net book value of their interstate switched access investment. Although rate-of-return carriers' revenue requirement might not be based on the precise measure of cost

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[1681] Indeed, within the range of just and reasonable rates it is possible that rates could be set at levels lower than those that generated the FY2011 revenues in certain cases, as discussed in greater detail below. *See infra* Section XIII.G.

[1682] To the extent that it subsequently is determined that an incumbent LEC's rates during the Baseline time period were not just and reasonable because they were too low, that carrier may seek additional recovery as needed through the Total Cost and Earnings Review Mechanism. *See infra* Section XIII.G.

[1683] *See, e.g.*, ABC Plan at 9.

[1684] *See, e.g., Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket No. 07-21, pp. 2-3 (filed Jan. 25, 2007) ("Under pure price cap regulation, rates are subject to price ceilings that are determined without reference to costs. Indeed, a key premise of price cap regulation is that consumers will benefit from increased efficiencies that will result from severing the relationship between rates and costs.").

[1685] *See, e.g., Petition of AT&T Inc. for Forbearance under 47 U.S.C. § 160 from Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket Nos. 07-21, 05-342, Memorandum Opinion and Order, 23 FCC Rcd 7302 (2008), *pet. for recon. pending, pet. for review pending, NASUCA v. FCC*, Case No. 08-1226 (D.C. Cir. filed June 23, 2008. In addition, the jurisdictional separations process has been frozen since 2001, and is currently subject to a referral to the Separations Joint Board. *See Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 26 FCC Rcd 7133 (2011); 47 C.F.R. Part 36.

[1686] As the Commission noted in 2009, "Many carriers no longer have the necessary employees and systems in place to comply with the old jurisdictional separations process and likely would have to hire or reassign and train employees and redevelop systems for collecting and analyzing the data necessary to perform separations." *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 24 FCC Rcd 6162, 6166 at para. 12 (2009); *see, e.g.*, Alexicon *USF/ICC Transformation NPRM* Comments at 2-4; TCA *USF/ICC Transformation NPRM* Comments at 4; ITTA *USF/ICC Transformation NPRM* Comments at 5-6.

we might otherwise adopt if we were starting anew, we believe that using those carriers' interstate revenue requirement is sensible for purposes of determining their Eligible Recovery. For one, this information is readily available today.[1687] In addition, use of the revenue requirement avoids implementation issues surrounding disputed or uncollectable interstate access revenues, providing greater predictability and substantially insulating small carriers from the harms of arbitrage schemes such as phantom traffic.[1688] This approach likewise prevents carriers that may have been earning in excess of their permitted rate of return from locking in those revenues and continuing such overearnings in perpetuity.

872. Our approach is also consistent with the reforms to local switching support (LSS) we adopt above. Historically, smaller carriers have received LSS as a subsidy for certain switching costs, effectively satisfying a portion of their interstate switched access revenue requirement.[1689] As discussed above, defining Eligible Recovery based on carrier's interstate switched access requirement allows us to eliminate LSS as a separate universal service support mechanism for rate-of-return carriers. Eligible Recovery will be calculated from carriers' entire interstate switched access revenue requirement—whether it historically was recovered through access charges or LSS. Thus, in essence, carriers receiving LSS today will be eligible to receive support as part of their Eligible Recovery.

873. At the same time, although rate-of-return carriers do track certain costs to establish their interstate revenue requirement for switched access services, the same information is not readily available—or necessarily relevant—for intrastate switched access services or net reciprocal compensation. As a result, their Eligible Recovery will be based on their FY2011 intrastate switched access revenues addressed as part of the reform adopted today plus FY2011 net reciprocal compensation as of April 1, 2012.[1690]

874. The *USF/ICC Transformation NPRM* also sought comment on whether, under a revenues-based approach, to base carriers' recovery on gross intercarrier revenue or alternatively to use net intercarrier compensation, defined as "a company's total intercarrier compensation revenue . . . less its intercarrier compensation expense" including expenses paid by affiliates.[1691] We received a mixed record

[1687] We will carefully monitor material changes in cost allocation to categories where recovery remains based on actual cost to ensure that carriers do not shift costs properly associated with switched access. We rely on the revenue requirement information available at the time of the initial tariff filings required to implement this recovery framework. This not only enables implementation of our recovery mechanism in the specified timeframes, but also addresses possible incentives to engage in gaming if carriers were able to increase the Rate-of-Return Baseline subsequently. If a carrier subsequently can demonstrate that it is materially harmed by the use of the projected, rather than final, 2011 interstate revenue requirement, it may seek a waiver of the rule specifying the Rate-of-Return Baseline to allow it to rely on an increased Rate-of-Return Baseline amount. Any such waiver would be subject to the Commission's traditional "good cause" waiver standard, rather than the Total Cost and Earnings Review specified below. *See* 47 C.F.R. § 1.3.

[1688] *See, e.g.*, ERTA July 8, 2011 *Ex Parte* Letter. For price cap carriers, there is no revenue requirement to use for this purpose. Consequently, we discuss below the extent to which price cap carriers will be able to include currently disputed ICC revenues in their FY2011 baseline. *See infra* para. 880.

[1689] 47 C.F.R. § 69.106(b).

[1690] Rate-of-return carriers may elect to have NECA or another entity perform the annual analysis. The underlying data must be submitted to the relevant state commissions, to the Commission, and, for carriers that are eligible for and elect to receive CAF, to USAC.

[1691] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4731, para. 567.

in response.[1692] For the reasons described below, the approach we adopt is neither a pure net revenue approach nor a pure gross revenue approach.

875. Although we are sympathetic to requests to determine recovery based on net revenues, we decline to do so for several reasons. Most importantly, we are committed to a gradual transition with sufficient predictability to enable continued investment, and a net revenue approach could reduce that predictability,[1693] especially for non-facilities-based providers of long distance service who pay intercarrier compensation expenses indirectly through their purchase of wholesale long distance service from third parties.

876. There also are other difficulties, substantive and administrative, involved in calculating net revenues, which cannot be adequately addressed based on the information in the record. For example, although reductions in an individual incumbent LEC's ICC revenue is tied to a particular study area, its affiliated IXC or wireless carrier may operate across multiple study areas, and the record does not suggest an administrable method for accurately identifying the cost savings associated with a particular incumbent LEC. Moreover, determinations of which affiliates should be counted, whether they are fully owned by the incumbent LEC or not, and to what extent, would be highly company-specific and could lead to inequitable treatment of similarly-situated carriers.

877. Such an approach also could create inefficient incentives during the transition regarding the acquisition of exchanges with ICC revenue reductions. For example, if an incumbent LEC has a large reduction in ICC revenue that is offset by affiliates' ICC cost savings, other carriers that lack affiliates with comparable ICC cost savings will be deterred from acquiring such exchanges if they would not be able to obtain additional recovery once it acquired that exchange. Conversely, if a carrier that lacked affiliates with comparable ICC cost savings *would* be entitled to new recovery if it acquired that exchange, a net revenue recovery approach could create inefficient incentives to acquire such exchanges given the potential for expanded CAF support (and thus also risk unconstrained growth in universal service).

878. Finally, although the record does not enable us to determine the precise extent to which savings will be passed through from IXC to incumbent LEC, competition in the long distance market is likely to lead IXCs to pass on significant savings to incumbent LECs, rendering 100 percent gross revenues likely more generous than necessary for incumbent LECs.[1694] This is further complicated by incumbent LECs with affiliated IXCs that provide wholesale long distance service; counting the cost savings associated with wholesale long distance service against the recovery need for the affiliated

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[1692] *Compare, e.g.*, Nebraska Rural Independent Companies' *USF/ICC Transformation NPRM* Comments at 30 (advocating a net approach); NASUCA *USF/ICC Transformation NPRM* Comments at 112-14 (same); COMPTEL *USF/ICC Transformation NPRM* Comments at 36 (same) *with, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 35-37 (arguing against a net approach); ITTA *USF/ICC Transformation NPRM* Comments at 29 (same); Kansas Corporation Commission *USF/ICC Transformation NPRM* Comments at 42 (arguing that a net approach would have a minimal impact for many Kansas incumbent LECs).

[1693] *See supra* Section VII.D.11.

[1694] *See, e.g.*, Testimony of Robert W. Quinn, Senior Vice President—Federal Regulatory, AT&T, at FCC Universal Service Fund and Intercarrier Compensation Workshop, April 6, 2011, CC Docket No. 01-92 at 66, transcript *available at* http://www.fcc.gov/events/universal-service-fundintercarrier-compensation-reform-workshop.; AT&T *USF/ICC Transformation NPRM* Comments at 36; *see also USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732-33, para. 571, (*citing* DEBRA J. ARON, *ET AL.*, AN EMPIRICAL ANALYSIS OF REGULATOR MANDATES ON THE PASS THROUGH OF SWITCHED ACCESS FEES FOR IN-STATE LONG-DISTANCE TELECOMMUNICATIONS IN THE U.S. at 6-11, 30-31 (Oct. 14, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1674082).

incumbent LEC could create disincentives for the IXC to simultaneously pass through those cost savings in lower wholesale long distance rates, thereby reducing the potential for lower retail long distance rates.

2. Calculating Eligible Recovery for Price Cap Incumbent LECs

879. For price cap carriers, the recovery mechanism allows them to determine at the outset exactly how much their Eligible Recovery will be each year. The certainty regarding this recovery will enable price cap carriers to better manage the transition away from intercarrier compensation for recovery. Our recovery approach will use historical trends regarding changes in demand to project future changes in demand (typically MOU), in conjunction with the default rates specified by our reforms, to determine Eligible Recovery.[1695] Specifically, under our mechanism, Price Cap Eligible Recovery will be calculated from a Baseline of 90 percent of relevant FY2011 revenues, reduced on a straight-line basis at a rate of ten percent annually starting in year one (2012). This is consistent with the historical trajectory of decreasing MOU,[1696] with which price cap carriers' intercarrier compensation revenues decline today. We conclude this approach provides the necessary predictability for carriers[1697] without reducing their incentives to seek efficiencies or to maximize use of their network. We will not annually true-up actual MOU for price cap carriers, instead likewise using a straight line decline of 10 percent relative to FY2011 MOU, which is a more predictable and administratively less burdensome approach. If MOU decline is less than 10 percent, carriers will receive the benefit of additional revenues. Conversely, if MOU decline accelerates, the risk of decreased revenues falls on the carriers. This allocation of risk incents carriers to be more efficient and retain customers.

880. Specifically, the Price Cap Baseline for price cap incumbent LECs' recovery will be the total switched access revenues that: (1) are being reduced as part of reform adopted today; (2) are billed for service provided in FY2011; and (3) for which payment has been received by March 31, 2012. In addition, the Baseline will include net reciprocal compensation revenues for FY2011, based on net payments as of March 31, 2012. Carriers will be required to submit to the states data regarding all FY2011 switched access MOU and rates, broken down into categories and subcategories corresponding to the relevant categories of rates being reduced. With this information, states with authority over intrastate access charges will be able to monitor implementation of the recovery mechanism and compliance with our rules, and help guard against cost-shifting or double dipping by carriers.[1698] A price cap incumbent LEC that is eligible to receive CAF shall also file this information with USAC for purposes of implementing CAF ICC support, and we delegate to the Wireline Competition Bureau authority to work with USAC to develop and implement processes for administration of CAF ICC support.[1699] These

[1695] We recognize that our transitional intercarrier compensation framework sets default rates but leaves carriers free to negotiate alternatives. Our approach to recovery relies on the default rates specified by our transition and will impute those rates for purposes of determining recovery, even if carriers negotiate a lower ICC rate with particular providers.

[1696] *See infra* paras. 885-886.

[1697] *See, e.g.*, FCC Universal Service Fund and Intercarrier Compensation Workshop, April 6, 2011, CC Docket No. 01-92 at 97, transcript *available at* http://www.fcc.gov/events/universal-service-fundintercarrier-compensation-reform-workshop. (comments of Paul Gallant, Senior Vice President and Telecom Analyst, MF Global, discussing the importance of certainty of access revenue to continued investor support for broadband build-out).

[1698] *See supra* paras. 812-813. Upon request, carriers will also be required to file these data with the Commission.

[1699] USAC plays a critical role in the day-to-day administration of universal service support mechanisms, *see, e.g.*, *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4595, para. 116 n.192, including the ICC-replacement CAF support that is part of our recovery mechanism.

figures will establish the Base Minutes for each relevant category, and shall not include disputed revenues or revenues otherwise not recovered, for whatever reason, or the MOU associated with such revenues. Every carrier, in support of its annual access tariff filing, must also provide data necessary to justify its ability to impose an ARC, including the potential impact of the ARC for residential and multi-line business customers.

881. In determining the recovery mechanism, we decline to provide 100 percent revenue neutrality relative to today's revenues. Rather, we adopt an approach that is informed in part based on the *status quo* path facing price cap carriers today, where intercarrier compensation revenues decline as MOU decline,[1700] but also adopt some additional reductions for carriers that have had the benefit of interstate rates essentially being frozen for almost a decade, rather than being reduced annually as would typically occur under price cap regulation. Thus, for study areas of carriers that participated in the *CALLS* plan, which is approximately 95 percent of all price cap lines, and 90 percent of all lines across the country, we adopt a 10 percent initial reduction in price cap incumbent LECs' Eligible Recovery to reflect the fact that these carriers' productivity gains have generally not been accounted for in their regulated rates for many years. Incentive regulation typically provides a mechanism for sharing the benefits of productivity gains with ratepayers.[1701] Prior to the *CALLS Order* in 2000, the Commission included a productivity adjustment to the price cap indices to ensure that savings would be shared.[1702] The *CALLS Order* did not include a productivity-related adjustment, however, providing instead a transitional "X-factor" designed simply to target the lower rates specified in that reform plan.[1703] After the targeted rates were achieved, which occurred by 2002 for 96 percent of study areas for carriers participating in the *CALLS* plan, the X-factor was set equal to inflation for the carriers originally subject to the *CALLS* plan and provided no additional consumer benefit from any productivity gains.[1704] As a result, study areas of price cap LECs that participated in the *CALLS* plan have had no X-Factor reductions to their price cap indices (PCIs), productivity-related or otherwise, for any PCI at least since 2004, and some price cap carriers' X-Factor reductions to their switched access-related PCIs stopped even earlier than that.[1705]

882. The record supports the use of a productivity factor such as the X-factor previously applied to price-cap carriers to reduce the amount carriers are eligible to recover through a recovery

[1700] *See infra* paras. 885-886. Although we adopt rules to help address concerns about traffic identification and establish a prospective intercarrier compensation framework for VoIP-PSTN traffic, absent our actions in this Order, issues regarding compensation for that traffic would not have been resolved. Because we are considering the *status quo* path absent reform, our recovery framework is based on historical declining demand notwithstanding reforms that potentially could mitigate some of that decline.

[1701] David E.M. Sappington, *Price Regulation*, in Handbook of Telecommunications Economics, Vol. I, 225, 231, 248-53 (Martin E. Cave et al. eds., 2002).

[1702] *See Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, 18 FCC Rcd 14976 at 14997-98, para. 35 (2003) (*CALLS Remand Order*).

[1703] *CALLS Order*, 15 FCC Rcd at 13028-29, paras. 160-63.

[1704] *See id.*, 15 FCC Rcd at 13028-29, paras. 160-63.

[1705] Because price cap carriers reached their target rates at different times, the inflation-only X-factor took effect at different times for different price cap carriers. In the *CALLS Remand Order*, the Commission concluded that price cap carriers serving 36 percent of total nationwide price cap access lines had achieved their target rates by their 2000 annual access filing. *CALLS Remand Order*, 18 FCC Rcd at 15002, para. 43, 15010-13, App. B. By the 2001 annual accessing filings the number grew to carriers serving 75 percent of total access lines, and by the 2002 annual access filings, carriers serving 96 percent of total access lines had achieved their target rates. *Id.*

mechanism.[1706] A productivity factor would require recovery to decrease annually by a predetermined amount designed to capture for consumers the efficiencies found to apply generally to the industry. For example, if we had maintained a five percent annual X-factor, rates for carriers that had reached their target rates would have been subject to caps reduced by five percent each year, so by today those rate caps would have been reduced by approximately 30 percent. Although the record does not contain the detailed analysis required to support a particular productivity factor that would apply on an ongoing basis,[1707] we find this initial 10 percent reduction for study areas of price cap LECs that participated in the *CALLS* Plan to be a conservative approach given the absence of any sharing of productivity or other X-factor reductions for a number of years, particularly when supplemented by other justifications for revenue reductions that we do not otherwise account for in our standard recovery mechanism.[1708]

883. We recognize, however, that the industry has changed significantly since the 2000 *CALLS Order*, with some price cap *CALLS* carriers merging with or acquiring carriers that did not participate in the *CALLS* plan and/or newly converted price cap carriers acquiring study areas that did participate in the *CALLS* plan. For this reason, we conclude it is necessary to apply the 10 percent reduction on a study area basis for *CALLS* participants, which we collectively define as "CALLS study areas." Thus, we will apply the 10 percent reduction to all price cap study areas that participated in the *CALLS* plan.[1709]

884. We also recognize, however, some price cap LECs converted to price cap regulation from rate-of-return regulation within the last five years and therefore such carriers did not participate in the *CALLS* plan. Thus, not all price cap carriers have had the benefit of productivity gains associated with reaching their target rates by 2002.[1710] Indeed, there are a few study areas that have converted to price cap regulation in the last two years and are still in the process of reducing their interstate rates to meet their *CALLS* target rate. As a result, for non-price cap study areas that were not part of the *CALLS* plan, we believe a more incremental approach is warranted.[1711] In particular, for non-*CALLS* study areas, we

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[1706] *See generally* CRUSIR *USF/ICC Transformation NPRM* Comments at 8 ("An X-factor should be applied to [price cap] carriers on an ongoing basis. Although productivity is one factor to note, so is the decreasing cost of the optical transmission gear and switching equipment used by these carriers."); Ad Hoc *USF/ICC Transformation NPRM* Comments at 33-38; Free Press *USF/ICC Transformation NPRM* Comments at 8. *But see* AT&T *USF/ICC Transformation NPRM* Reply at 38-39. ("In the 20th century, it was appropriate to impose such a productivity factor on price-cap carriers to reflect the declining per-line costs of providing service, which resulted from both efficiency improvements and steady increases in line counts . . . . Over the past decade, however, ILECs have hemorrhaged access lines, and their per-line costs have—if anything—increased.").

[1707] *See, e.g., USTA v. FCC*, 188 F.3d 521, 525-530 (D.C. Cir. 1999) (reversing and remanding for further explanation the Commission's prescription of a 6.5 percent productivity factor).

[1708] As discussed below, we consider these additional factors more specifically in the context of any Total Cost and Earnings Review requested by an incumbent LEC to justify a greater recovery need. *See infra* Section XIII.G.

[1709] All incumbent LECs subject to price cap regulation at the time of the *CALLS Order* elected to participate in the *CALLS* plan. *See, e.g., Iowa Telecom Forbearance Order*, 17 FCC Rcd 24319 (2002). *See also CALLS Remand Order*, 18 FCC Rcd at 15010-13, App. B (listing carriers subject to the *CALLS Order*).

[1710] *See supra note* 1705.

[1711] The Commission sought comment in the *USF/ICC Transformation NPRM* on whether any intercarrier compensation reform recovery mechanism should differ depending upon the type of carrier. *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732-33, para. 571. Likewise, carriers have advocated in this proceeding that the Commission's intercarrier compensation reforms accommodate the particular needs of carriers that converted to price cap regulation subsequent to *CALLS*. *See, e.g.*, ACS *August 3 PN* Reply at 4 (advocating different treatment under any intercarrier compensation reform given its recent conversion to price cap regulation); (continued...)

will delay the implementation of the 10 percent reduction to Eligible Recovery for five years, which is approximately the difference in time between when 96 percent of study areas of *CALLS* price cap carriers reached their target rates in 2002 and when the non-*CALLS* price cap carriers began converting from rate-of-return in 2007. We believe doing so enables carriers that more recently converted to price cap regulation, carriers which are typically smaller, have additional time to adjust to the intercarrier compensation rate reductions. In year six, the 10 percent reduction to Eligible Recovery will apply equally to all price cap carriers.

885. In addition, as discussed in the *USF/ICC Transformation NPRM*, Commission data and the record confirm that carriers are losing lines and experiencing a significant and ongoing decrease in minutes-of-use.[1712] Incumbent LEC interstate switched access minutes have decreased each year since 2000,[1713] as shown in the chart below.[1714]

(Continued from previous page)

Letter from Russell M. Blau, counsel for Consolidated, to Marlene H. Dorth, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109; CC Docket Nos. 01-92, 96-45; GN Docket No. 09-51 at 1 (filed Aug. 22, 2011) (expressing concern with the impact of certain universal service and intercarrier compensation reform proposals "especially those that recently and voluntarily converted to price cap regulation"); Windstream *2008 Order and ICC/USF FNPRM* Comments at 22 & n.49 (advocating intercarrier compensation reform and an accompanying recovery mechanism that accommodates the needs of carriers that recently converted to price cap regulation); Letter from Eric N. Einhorn, V.P. Federal Government Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 06-122, 08-152, 07-135; CC Docket Nos. 01-92, 96-45, 99-68 at 5 (filed Oct. 27, 2008) (same).

[1712] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732, para. 570; *Sept. 2010 Trends in Telephone Service*, at Table 7.1, Chart 10.1; 2010 Universal Service Monitoring Report at Table 8.1; Letter from Donna Epps, Vice President – Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135 at 1 (filed Oct. 28, 2010); *see also* PAETEC *USF/ICC Transformation NPRM* Comments at 33-34.

[1713] *2010 Trends in Telephone Service*, Table 10.1.

[1714] Network Usage by Carrier, Annual Submission by NECA of Access Minutes of Use, *available at* http://transition.fcc.gov/wcb/iatd/neca.html (Tier-1 NECA and Non-NECA Companies).

Interstate Switched Access Minutes for Incumbent LECs (In Billions) [1715]

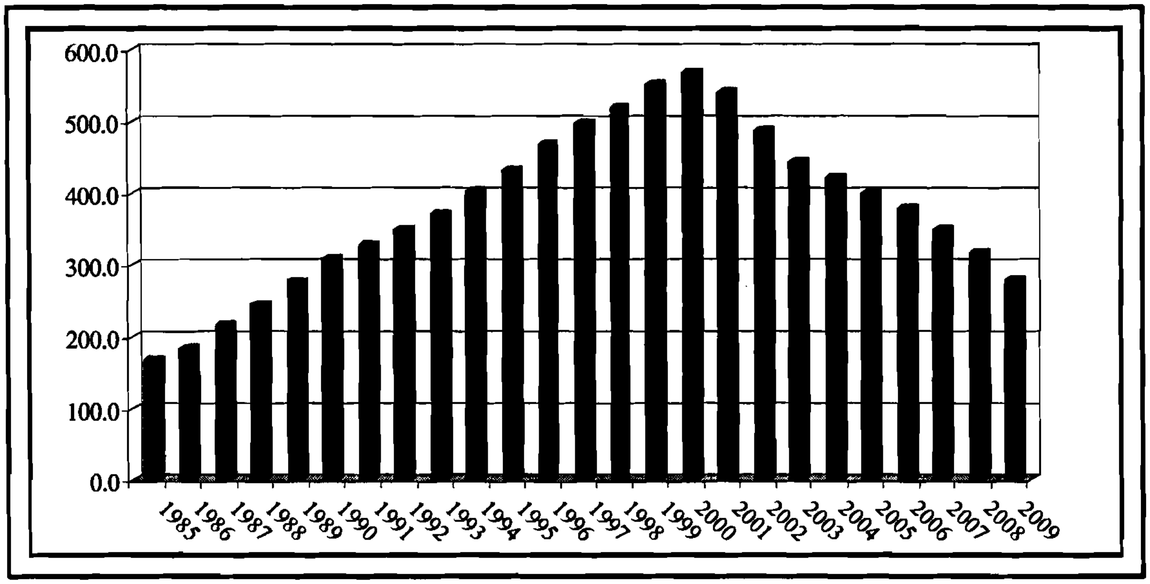

Figure 10

886. This represents an average annual decrease of over 10 percent and a total decrease of over 36 percent since 2006.[1716] Further, the percentage loss of MOU is accelerating—it increased each year between 2006 and 2010, and exceeded 13 percent in 2010.[1717] Based on the record, it is our predictive judgment that significant declines in MOU will continue.[1718] Accordingly, we will reduce Price Cap Eligible Recovery by 10 percent annually for price cap carriers to reflect a conservative prediction regarding the loss of MOU, and associated loss of revenue, that would have occurred absent reform.

887. As a result, for price cap carriers, Base Minutes will be reduced by 10 percent annually beginning in 2012 to reflect decline in MOU. For example, Year One or "Y1" (2012) Intrastate Minutes will be .9 x Intrastate Base Minutes; Y2 (2013) Intrastate Minutes will be .81 x Intrastate Base Minutes (i.e., .9 x .9 x Intrastate Base Minutes); etc.

[1715] *See* IATD, Wir. Comp. Bur., Universal Service Monitoring Report, Chart 8.1 (Dec. 2010).

[1716] Network Usage by Carrier, Annual Submission by NECA of Access Minutes of Use, *available at* http://transition.fcc.gov/wcb/iatd/neca.html (Tier-1 NECA and Non-NECA Companies); *see also* Letter from Stuart Polikoff, Director of Government Relations, OPASTCO, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 01-92, 96-45, Attach. at 12-13 (filed May 27, 2008) (providing a 2008 projection that, over the subsequent three years, "intrastate access revenues will decline by between 5% and 12% per year (with 8% as the most likely annual decline)").

[1717] *Id.*

[1718] *See, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 54 ("The legacy POTS business model is declining at an astonishing rate. Incumbent carriers are hemorrhaging customers to competitors...."); Verizon and Verizon Wireless *USF/ICC Transformation NPRM* Comments at 20 ("[D]isbursements from the fund should take into account the overall declining nature of switched access revenues.").